CHAPTER I

INTRODUCTION

A. Background

In this modern era, many companies want to continue to develop their companies. The development of a good company generally can be seen from good financial performance following the expected goals. To achieve excellent financial performance, every company has a big responsibility that will affect the development of the company. This responsibility is given to stakeholders involved in the running of a business to expand corporate accountability beyond financial accountability (Yip et al., 2011). Employees, shareholders, suppliers, consumers, communities and the surrounding environment are stakeholders who come from internal and external parties. This responsibility is a social responsibility that can measure the extent to which the company is aware of developing while providing benefits to the surrounding environment.

Social responsibility is known as corporate social responsibility (CSR). CSR is defined as a business responsibility to support the expectations of the community and also stakeholders in environmental, social and economic aspects (Suyono & Farooque, 2018). CSR emerged as a result of conflict between community and company because the effects that arise from a company's existence and operations to the environment (Bidhari et al., 2013).

The company cannot be assessed only through its financial performance, but also its social performance or Corporate Social Responsibility (Kamatra & Kartikaningdyah, 2015a). CSR is a condition where people or a company can care and respond well to the circumstances around them. A response generated will have much impact on the company's image and a good response will certainly improve the performance of the company. Corporate social responsibility or commonly known as the triple bottom line (Economic, Social, and Environmental) is a concept where CSR includes three main dimensions. These three dimensions are seeking profit (economic) for the company, empowering the community (people or social), and maintain the preservation of nature or earth (planet or environment). All of that is because in carrying out its operational activities the company will interact directly or indirectly with its environment.

In the beginning, CSR was carried out by some companies to build a positive image in the community and shareholders. However, in 2007, Indonesia required companies that had businesses related to natural resources to carry out these social responsibilities (Arief & Ardiyanto, 2014). This can be seen in Law No. 40 concerning Limited Liability Company article 74 which stated that companies that carry out business activities in the field or related to natural resources must carry out social and environmental responsibilities. Besides, under the Investment Law No. 25 of 2007 Article 15 (b) stated that every investor is obliged to carry out corporate social responsibility and Article 34 stated that companies that do not fulfill the obligations specified in Article

15 will be subject to administrative sanctions in the form of written warnings, cancellation of business activities, freezing business activities and or investment facilities, or the embedding of business activities and investment facilities.

The policies set out in the act make companies have to report CSR activities in the annual report. Of course, the disclosure of CSR in annual reports is the company's strategy to continue to increase profits. Profit is one of the indicators contained in the company's financial statements that investors use to make decisions. Therefore, investors are in desperate need of excellent earnings quality (Arief & Ardiyanto, 2014). Management in the company has the right to make policies on the company's financial statements to achieve particular objectives, including good earnings quality. One of these policies is earnings management.

Earnings management is interpreted when managers use valuations in financial reporting and in compiling transactions to change financial statements either to mislead some stakeholders about the underlying economic performance of the company or to influence contract outcomes depending on the accounting figures reported (Healy & Wahlen, n.d.). Earnings management can be used to reduce the interference and to protect the private control benefits (Amidu & Kuipo, 2015). According to Amar & Chakroun (2018), there are two perspectives from doing earnings management, namely the opportunistic perspective and the signaling or informational perspective. The opportunistic perspective explained that earnings management is used to maximize wealth such as maximizing their compensation bonus. Furthermore, the signaling or informational perspective explained that earnings management is used to signal the company's prospects. The existence of this social responsibility activity can make management within the company freer to practice earnings management because CSR activities will make a positive response in the eyes of investors and the public.

Disclosure of CSR activities in annual reports will make financial information in financial statements clearer and more transparent (Putriana et al., 2018). The shareholders and parties that need annual reports in making decisions will be more confident about the annual reports issued by the company. Socially responsible companies that spend their business and resources in choosing and implementing corporate social responsibility practices to fulfill the ethical expectations of shareholders in the community tend to limit the use of profit management to provide investors with more transparent and reliable financial information.

Research on the relationship between corporate social responsibility (CSR) and earnings management has been carried out and has many differences in results. Research conducted by Prior, Surroca, & Tribó (2008) found that there was a positive influence between CSR and earnings management. While, Hong & Andersen (2011) found that there was a negative relationship between CSR disclosure and earnings management. Kim, Park, & Wier (2012) also found that there was a negative and significant relationship between CSR and the quality of earnings through earnings management. Nastiti (2010) and

Grougiou, Leventis, Dedoulis, & Owusu-Ansah (2014) found that there was a negative and not significant influence between CSR and earnings management. According to Grougiou et al. (2014), CSR disclosures do not guarantee an increase or decrease in earnings management practices at U.S Banks. Gargouri, Shabou, & Francoeur (2010) found a positive and significant relationship between corporate social performance and earnings management. Yip, Staden, & Cahan (2010) found there was a negative and significant relationship between CSR and earnings management in oil and gas companies, and there was a positive and significant relationship in food companies.

This research refers to research conducted by Amar & Chakroun, (2018) who examined the effect of corporate social responsibility (CSR) on earnings management. Similar to Hong & Andersen (2011) research, Amar & Chakroun (2018) research also found a negative relationship between CSR and earnings management. The research itself has several differences from the research conducted by Amar & Chakroun (2018). In Amar & Chakroun (2018) research, Corporate Social Responsibility as an independent variable was measured using the ISO 26000 standard and also measured for each component in the ISO 26000 standard, which in this research measured CSR using the ISO 26000 standard by combining all components and not counting them separately but counting thoroughly. At the same time, Earnings Management as a dependent variable is measured through discretionary accruals based on Dechow et al. (1995) model with CFO, which in this research was measured using discretionary accruals using the Modified Jones (1991) model. The Modified

Jones model is used in this study because it is considered to be the best model for detecting earnings management. Moreover, Amar & Chakroun (2018) used several control variables, namely, size of the company, level of debts, and return on assets. While in this research, the control variables used were the same but added measurements of company growth because the company's growth was considered to predict the practice of earnings management and deleted variable size of the company.

From the background presented, the author is interested to conduct a research with the title **"THE EFFECT OF CORPORATE SOCIAL RESPONSIBILITY ON EARNINGS MANAGEMENT (Study of Consumer Goods Industry Sector Listed on the Indonesia Stock Exchange 2016-2019)"**

B. Research Problem

The CSR activities in the annual report will make financial information more transparent for those who use financial statements. This transparency will make management limit the use of earnings management practices. The relationship between disclosure of corporate social responsibility and the practice of earnings management has attracted attention because it is concerned with the sustainability of the company and the quality of earnings from the company. Moreover, this research involves several control variables that will make the results of the analysis more explain the phenomenon optimally because other variables that also influence dependent variables, the effect becomes interrupted. The control variables are level of debts, return on assets, and company growth.

1. Does corporate social responsibility (CSR) disclosure have influence on earnings management (EM)?
2. Does the level of debts (DEBT) have influence on earnings management (EM)?
3. Does return on assets (ROA) have influence on earnings management (EM)?
4. Does company growth have influence on earnings management (EM)?

C. Research Purposes

In connection with the research problem, these research purposes are:

1. To examine the effect of corporate social responsibility (CSR) disclosure on earnings management (EM).
2. To examine the effect of the level of debts (DEBT) on earnings management (EM).
3. To examine the effect of return on assets (ROA) on earnings management (EM).
4. To examine the effect of company growth on earnings management (EM).

D. Potential Research Contributions

This research is expected to be useful for many people and the things to be achieved are as follows:

a. For the researcher

To increase the knowledge associated with this study as a provision in applying the science that has been gained in college in the real working world.

b. For the company

To provide information to management or companies that carry out social responsibility activities to be disclosed in annual reports in order to produce high-quality financial and non-financial reports.

c. For investors

As a consideration in an investment decision making, in order to determine the company that can provide the expected rate of return on investment, without forgetting its social responsibility.

d. For the community

Provide an understanding of the application of corporate social responsibility to increase public awareness of the rights that must be obtained from the company.

E. Thesis Writing Systematics

Writing systematics is used in this research so that readers can easily understand the flow of research intended by the author. The research writing systematics used are as follows:

CHAPTER I: INTRODUCTION

In this chapter, the researcher includes background, research problems, research purposes, potential research contributions, and a thesis writing systematics.

CHAPTER II: LITERATURE REVIEW

In this chapter, the researcher explains the various theories that form the basis of analysis in this research which include: Stakeholder Theory, Theory of Legitimacy, Signaling Theory, and Corporate Social Responsibility (CSR). This chapter also includes the previous research, hypothesis, and research framework.

CHAPTER III: RESEARCH METHODOLOGY

In this chapter, the reseacher provides an explanation of research types, population and sample determination, types and data sources, data collecting methods, research variables and operational definition, and also data analysis method.

CHAPTER IV: RESULTS AND DISCUSSION

In this chapter the reseacher provides an explanation of the research object characteristic and also describes the results of the data analysis and its discussion.

CHAPTER V: CONCLUSION

This chapter contains conclusions, research limitations, and suggestion